



CONSTITUTIONAL CASE LAW ON ESTIMATED INCOME TAX

START THE TOUR

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Recently, the Plenary of the Supreme Court of Justice (SCJ) issued a judgment of June 22, 2021, as a result of the unconstitutionality action presented by BDO Legal on behalf of Rubén Bustamante R, against article 710 of the Fiscal Code, specifically the third, fourth, fifth and sixth paragraphs of article 710 of the Fiscal Code, which develop the Income Tax calculation mechanism (estimated Income Tax).

Through this ruling, the SCJ declares, unanimously, that the aforementioned mechanism of calculating the estimated income tax, based on the liquidation of the income tax caused in the previous fiscal period, is constitutional and does not violate (i) nor the principle of non-confiscation of goods; (ii) nor the principle of economic or contributory capacity protected by articles 30 and 264 respectively of the National Constitution.

1. POSITION OF THE PLAINTIFF

The plaintiff considered that the third, fourth, fifth and sixth paragraphs of article 710 of the Tax Code violated article 30 of the Political Constitution, the text of which is transcribed below:

"Article 30. There is no death penalty, no expatriation or confiscation of property."

The plaintiff states that the aforementioned article is violated, due to the requirement imposed by law in relation to the liquidation and determination of the estimated income tax, since the taxpayer must calculate the tax for the subsequent year based on income taxable obtained in the previous year which results in the sworn or caused tax, considering that the taxpayer will obtain at least the same taxable income results in the current year that he managed to obtain in the previous year.

As an example, the plaintiff sets out the situation of the fiscal period 2020, indicating that due to the situation of the COVID-19 Pandemic, many taxpayers will suffer losses instead of obtaining taxable income, which would reflect a confiscation of assets, since, for some taxpayers, being able to comply with the obligation to advance the estimated income tax during the year 2020, makes them commit their cash funds to advance a non-existent tax obligation, since the financial and accounting results of the year 2020 will result in financial and fiscal losses, consequently, without generating any obligation to pay income tax caused at the end of the fiscal year.

In the same way, the plaintiff also alleges that the third, fourth, fifth and sixth paragraphs of article 710 of the Fiscal Code violated article 264 of the Political Constitution, the text of which is transcribed below:

"Article 264. The Law shall endeavor, as far as possible, within the need to arbitrate public funds and to protect national production, that all taxes are levied on the taxpayer in direct proportion to their economic capacity." The plaintiff states that the infringement occurs because it forces the taxpayer to declare a fictitious estimated income, equal to or greater than that of the previous year, despite the fact that their real economic capacity in the subsequent fiscal year could be different, either being less or null, thus allowing the advance of a tax that is not going to be generated and that could be nonexistent.

Additionally, the plaintiff maintains that the analysis of the economic capacity must be carried out taking into account the system of self-assessment of the tax and that the income tax must be levied on the profit based on the economic capacity of the taxpayer to be able to collect the tax on a actual amount. Finally, the plaintiff considers that the fiscal year for which an income tax return was made deserves its own separate analysis of the taxpayer's economic capacity, totally differentiated from that following fiscal year, which is only still covered by an estimated tax return.

2. POSITION OF THE ATTORNEY OFFICE OF THE NATION

The Procurator of the Administration issues his criteria and establishes that there is no violation against **article 30** of the Political Constitution, since it is a sanction or pecuniary penalty imposed by the State as a consequence of the extinction of all rights of a person, that is, the case of civil death or loss of status as a subject of law, a phenomenon that has disappeared in most laws, it also does not conform to the provisions of the defendant paragraphs to an action for dispossession of the patrimony of the taxpayer by the State. On this point, the Attorney General's Office indicates that the amounts that have been delivered by the taxpayer to the Treasury are the product of the relationship of the subject of obligations with the State, which provides for budgets in which, if the balance is favorable to the taxpayer, could be credited to other tax debts and, ultimately, could request a refund of the credit.

On the other hand, the Procurator, in relation to the violation of **article 264** of the Political Constitution, which states that the estimated Income Statement does not constitute a tax as such, since it is considered as an act where the taxable income is averaged of the subsequent fiscal year, which must be assumed by the taxpayer in favor of the treasury. Additionally, the Attorney indicates that the Income Tax is constituted as a national tax that must be assumed by all taxpayers, however, Panamanian tax legislation has developed, over time, different measures to ensure the payment of said tax and, for such purposes, in support of the effective accounting projection of the taxpayer, it is required to make an estimate of its economic future that must be consigned to the treasury at the time of filing the declaration of the respective taxable year, and is proposed by fiction a tax guarantee that ensures the collection of Income Tax.

Finally, the Attorney General of the Nation concludes that the estimated return has been created in the Tax Law to guarantee the payment of the Income Tax of the taxpayers, and that it does not represent an action of dispossession of the taxpayer by the State however provides for budgets in which, if the balance is favorable to the taxpayer, this is credited to other tax debts, and ultimately, it could be returned.

3. DECISION OF THE PLENARY OF THE SUPREME COURT OF JUSTICE

The Plenary of the Court, after having studied with due attention the arguments presented by the plaintiff, in the claim of unconstitutionality, as well as the opinion expressed by the Procurator of the Nation, then proceeds to comply with the examination of the confrontation of the defendant paragraphs of article 710 of the Fiscal Code, object of this constitutional process, to establish, prior to the decision, the following considerations:

As a first point, the Magistracy makes it clear that it does not share the opinion of the plaintiff, considering that, when the Income Tax is settled and paid, according to the estimated income statement, Article 30 nor Article 264 of the Political constitution is not infringed.

In accordance with the Plenary of the Court, article 710 of the Tax Code, develops the obligation that the taxpayer has to present, personally or through an attorney or representative, a sworn statement of the income obtained during the previous taxable year, as well as the dividends or shares that it has distributed among its shareholders or partners, and the interests paid to its creditors. The defendant paragraphs specifically state:

I. the obligation of the tax payer to present together with the aforementioned declaration an estimated income tax declaration, which should not be less than that indicated in the sworn declaration (third paragraph);

II. the effect generated by the presentation of a estimated statement that reflects a lower balance than the sworn statement (fourth paragraph);

III. the way in which income tax is settled and paid and the adjustment that must be made between the affidavit and estimated return covering the same year and the effect that occurs if the adjustment results in a favorable balance to the State (fifth paragraph),

IV. or, to the taxpayer (sixth paragraph).

Regarding this analysis, the Plenary of the Court points out that it is indisputable that the norm imposes an advance payment of an income yet to be generated or non-existent, a requirement that, in extraordinary situations, as it has been with the COVID-19 Pandemic, can represent a heavy burden to the taxpayer, since it affects the performance of the taxpayer's business in the year in which the payment is made and settled; However, one cannot lose sight of the fact that it is a mechanism that benefits the Treasury in the collection of this tax.

Although extraordinary circumstances such as the COVID-19 Pandemic, may have an impact on the income obtained during the fiscal period 2020 for some taxpayers, causing them to be lower than those obtained in the previous fiscal period (2019), which should serve as the basis for the settlement and payment of the Estimated Income Tax, the Plenary of the Court considers that it should not be understood that it is a case of confiscation of assets.

Despite the fact that the taxpayer may have reported a higher or identical income for the period, it cannot be ignored that the Income Tax that is settled and paid is an estimate, that is, a temporary calculation that will depend on the income that has actually accrued. Consequently, it is valid to conclude, given the need to make an adjustment on the sums that the taxpayer pays due to the estimated return, they constitute an advance, a form of temporary collection for the purposes that the Treasury has a flow based on parameters objectives on the taxpayer's income, which is accompanied by measures that guarantee that the taxpayer's property is not affected.

Consequently, the Plenary warns that, even when the rule indicates that the liquidation and payment of income tax will be made in accordance with the estimated return, that is, part of a presumption and not of a real quantification, it is no reason to neglect the generating event or the tax obligation. It is evident that it is a temporary, anticipated collection mechanism, established for the legislator under an objective presumption of the income that the taxpayer must generate within the corresponding fiscal period, which does not constitute the payment of a tax as such but constitutes a credit that will be deducted from the amount that must be paid as income tax effectively caused, if this is the case, either applied or compensated to another tax and, if there is no tax to pay, it would be returned to the taxpayer.



4. OUR COMMENTS

This ruling of the SCJ enshrines an extremely formalistic position of the SCJ that is supported exclusively by the principle of tax legality, which is also provided for in the Magna Carta, but which was not a direct object of the constitutional dispute.

Considering that the decisions of the Plenary of the Supreme Court of Justice or of any of its Chambers, are final, definitive and of mandatory compliance, at BDO Legal we consider that in those particular cases in which an excess of tax burden is identified, the Governmental means for each affected taxpayer to request reparation or restitution of their rights. This is without prejudice to the possibility, unambiguously recognized by the Plenary of the SCJ itself, that taxpayers can effectively estimate an amount lower than the income tax paid in the previous fiscal period.

To this end, the recent modifications and innovations introduced in our legislation establish some alternatives in favor of taxpayers: (i) the refund of taxes; (ii) the compensation of tax credits and debits of the taxpayer or (iii) the transfer of tax credits in favor of third taxpayers, in accordance with the Fiscal Code (FC) and the Tax Procedure Code (TPC) that corresponds to the specific case.

Faced with a refusal by the Internal Tax Revenue Office (DGI, in Spanish), the taxpayer may take the case to the Administrative Tax Court (ATC) and subsequently to the 3rd Chamber (of Administrative Litigation) of the SCJ.

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